

CNB's New Forecast

Inflation Report IV/2009

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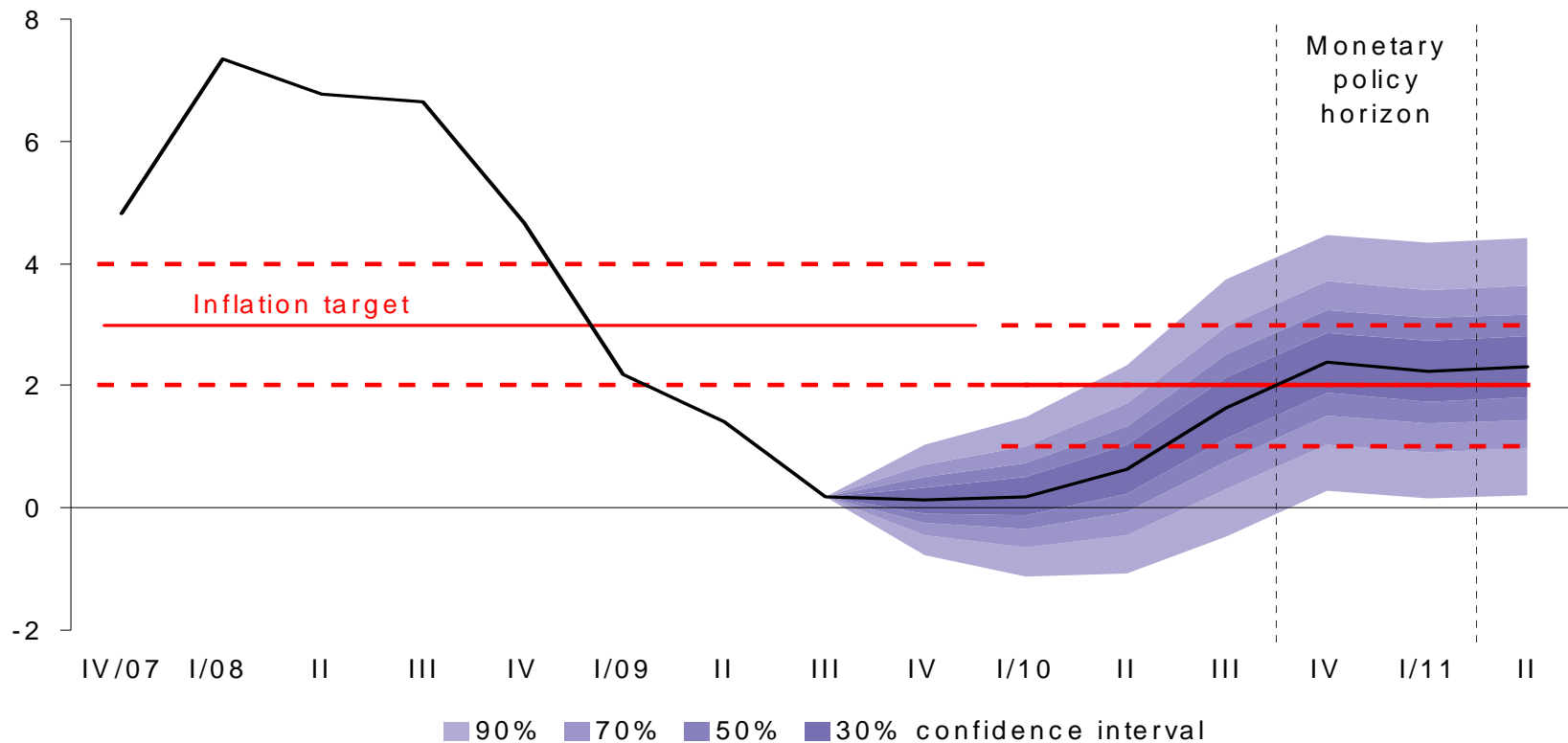
Monetary and Statistics Department

Meeting with analysts, Prague, 13 November 2009

Summary of the Inflation Forecast

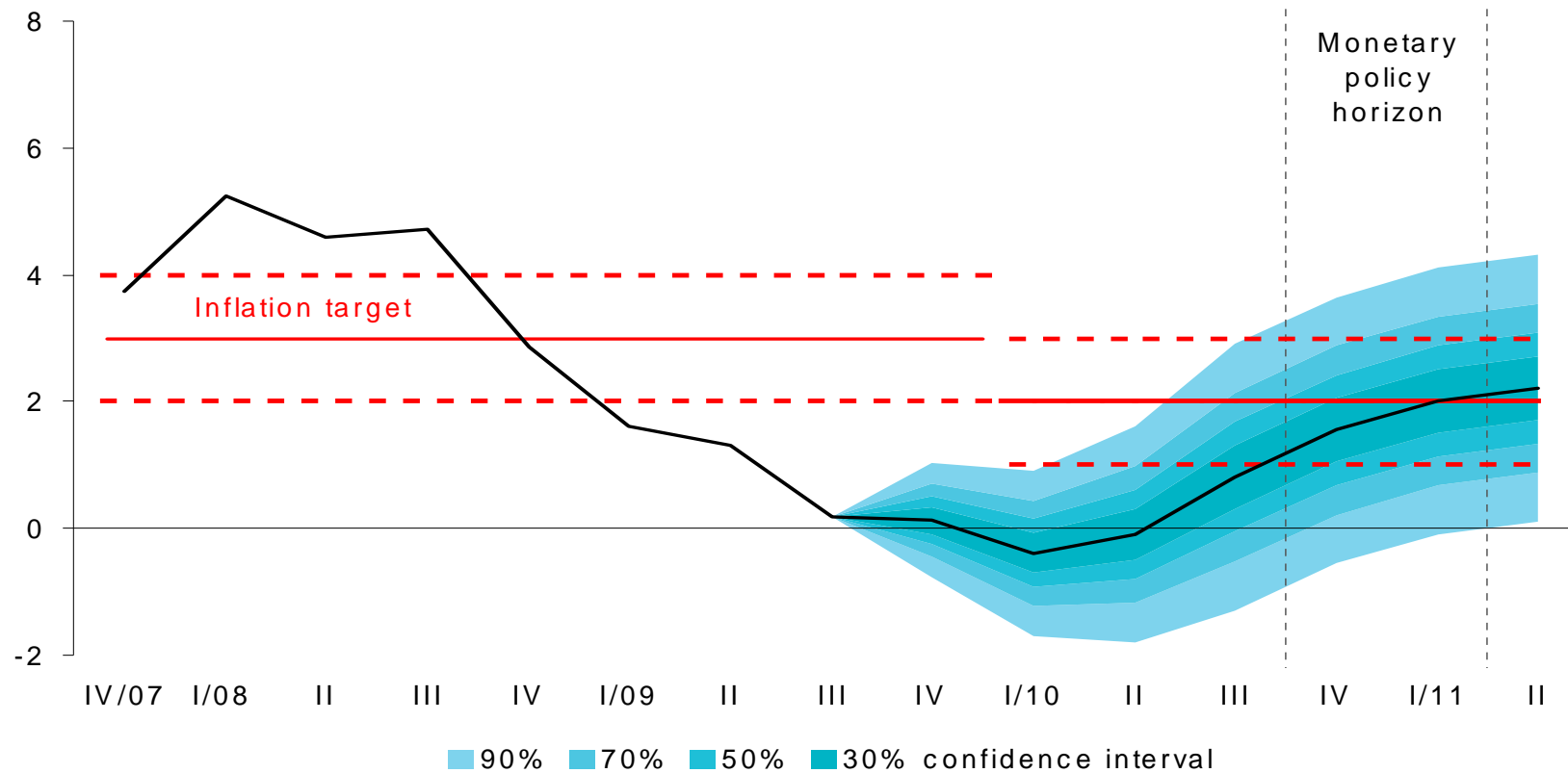
- Inflation will be close to zero in the near term; then it will increase towards the new 2% target during 2010;
- Inflation forecast was slightly reduced for the near term and increased for the medium term;
- The forecast revision is due mainly to a lower near-term outlook for market-determined prices and incorporation of indirect tax changes;
- The forecast of regulated prices was also slightly lowered for 2010;
- Both the import prices and domestic producer costs are falling, but not enough to offset the fall in prices – the margins are thus reduced and could recover when the economic activity starts to revive;
- The GDP will fall by 4.4% in 2009 and increase by 1.4% in 2010, substantial labour market slack will persist.

Headline Inflation Forecast



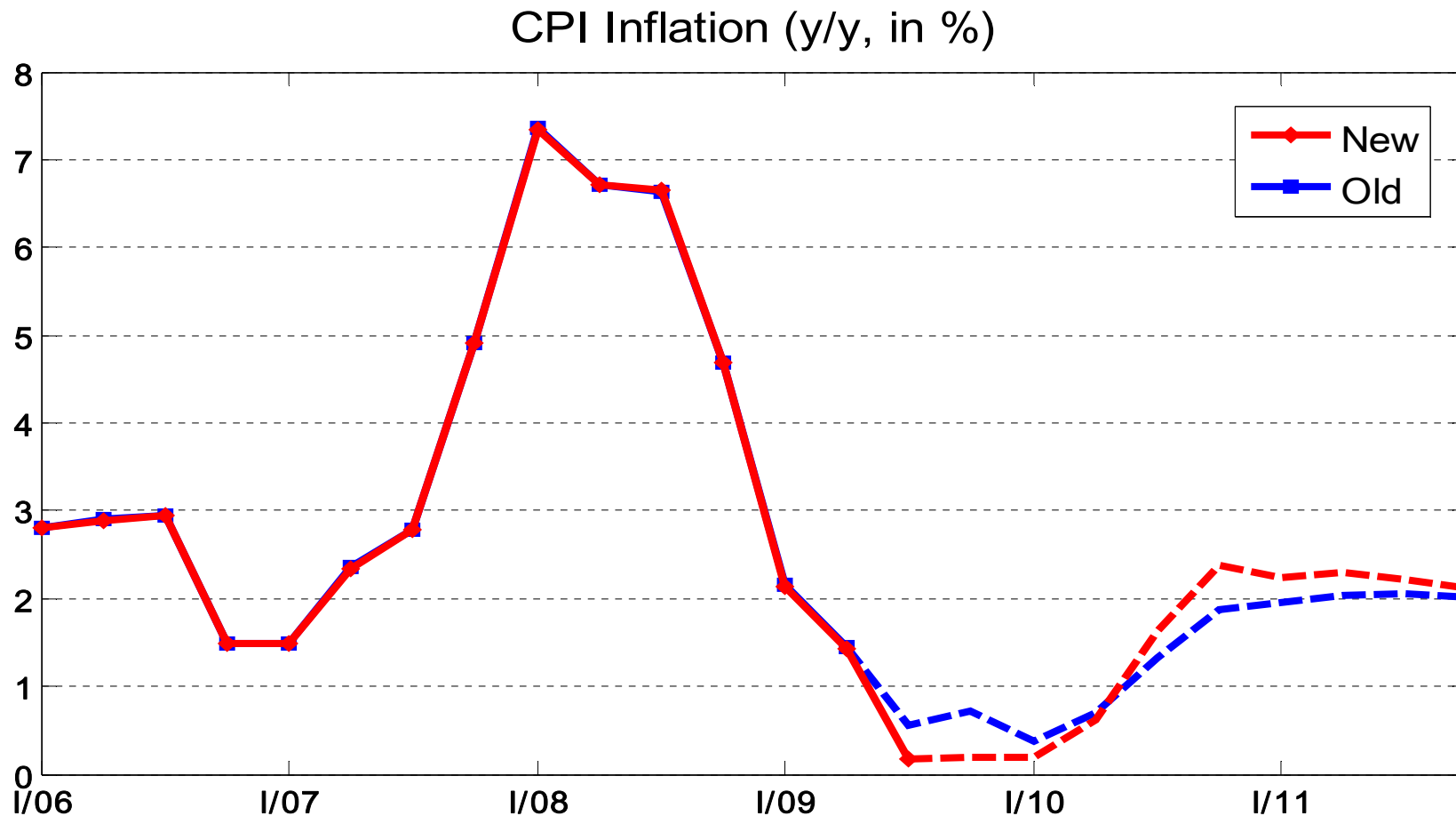
- October 2010 (-0.2% y/y) was probably the only month with negative inflation, but inflation will remain very low in the near-term;
- Forecast slightly above the 2% target on the MP horizon due to indirect tax changes.

MP-Relevant Inflation Forecast



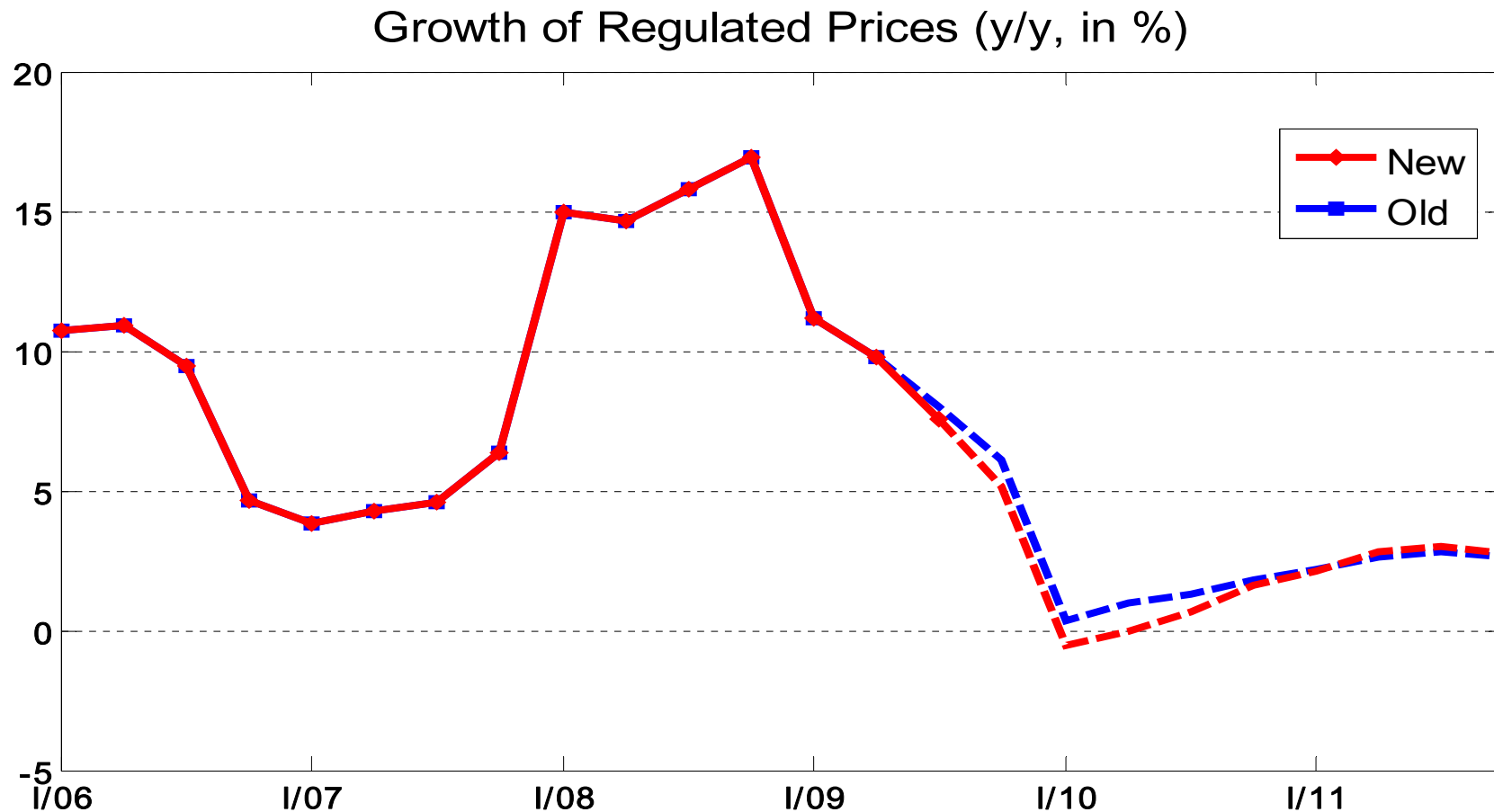
- MP-relevant inflation forecast below the headline inflation;
- Temporarily negative at the turn of 2010;
- Approaching the new inflation target from below.

Comparison with Previous Inflation Forecast



- The forecast is slightly below the old one in the near term;
- On the MP horizon, forecast was increased due to tax changes.

Regulated Prices



- The forecast of regulated prices is marginally lower in 2010 due to decreased outlook for regulated prices.

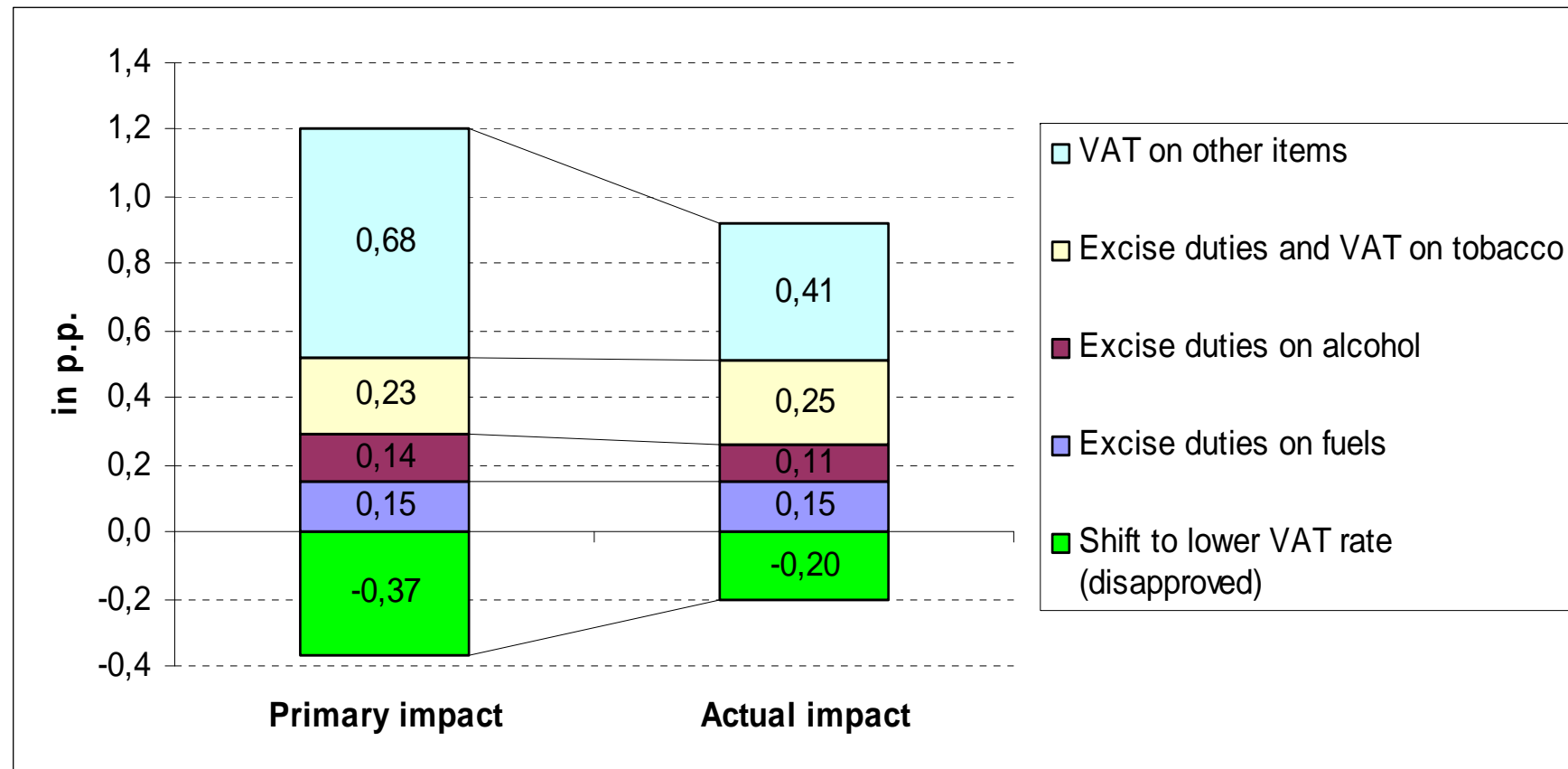
Administrative Measures

(selected items and total impact; end-of-year)

	2009		2010		2011	
	Y/Y growth	Impact in p.p.	Y/Y growth	Impact in p.p.	Y/Y growth	Impact in p.p.
Regulated prices - total	4.6	0.89	1.1	0.22	3.2	0.64
of which (selected items):						
Regulated rents	27.0	0.55	16.0	0.41	8.5	0.25
Electricity	11.6	0.47	-6.0	-0.27	2.0	0.08
Natural gas	-12.5	-0.36	-8.0	-0.20	4.0	0.09
Heating	2.8	0.09	2.9	0.10	2.0	0.07
Healthcare	-4.6	-0.08	2.6	0.05	2.0	0.04
Primary impact of tax changes on non-regulated prices		0.00		0.71		0.00

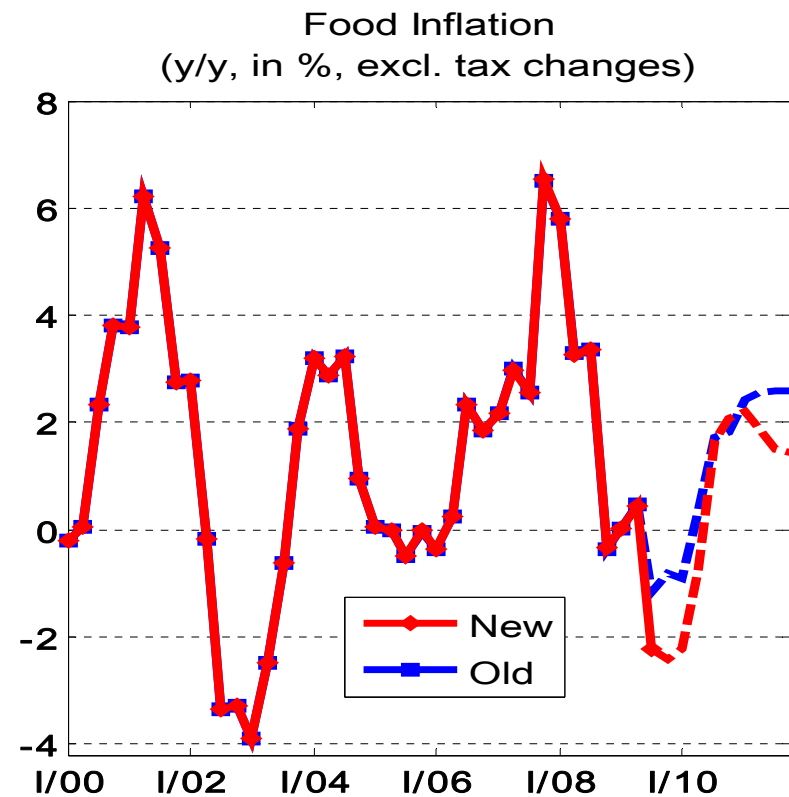
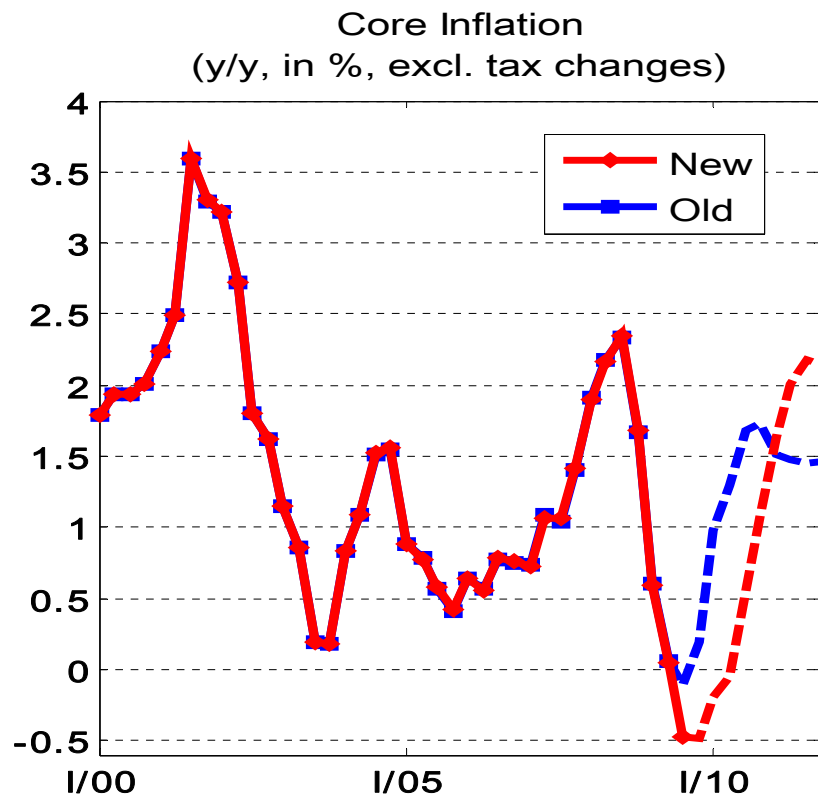
- Falling electricity and gas prices expected for 2010;
- Overall primary impact of indirect tax changes included in the fiscal austerity package: 1.2 p.p. (partly in regulated prices);
- Note: the forecast also includes a shift to the lower VAT rate for certain services (primary impact -0.37 p.p.), which was recently rejected by the Parliament.

Summary of Indirect Tax Changes



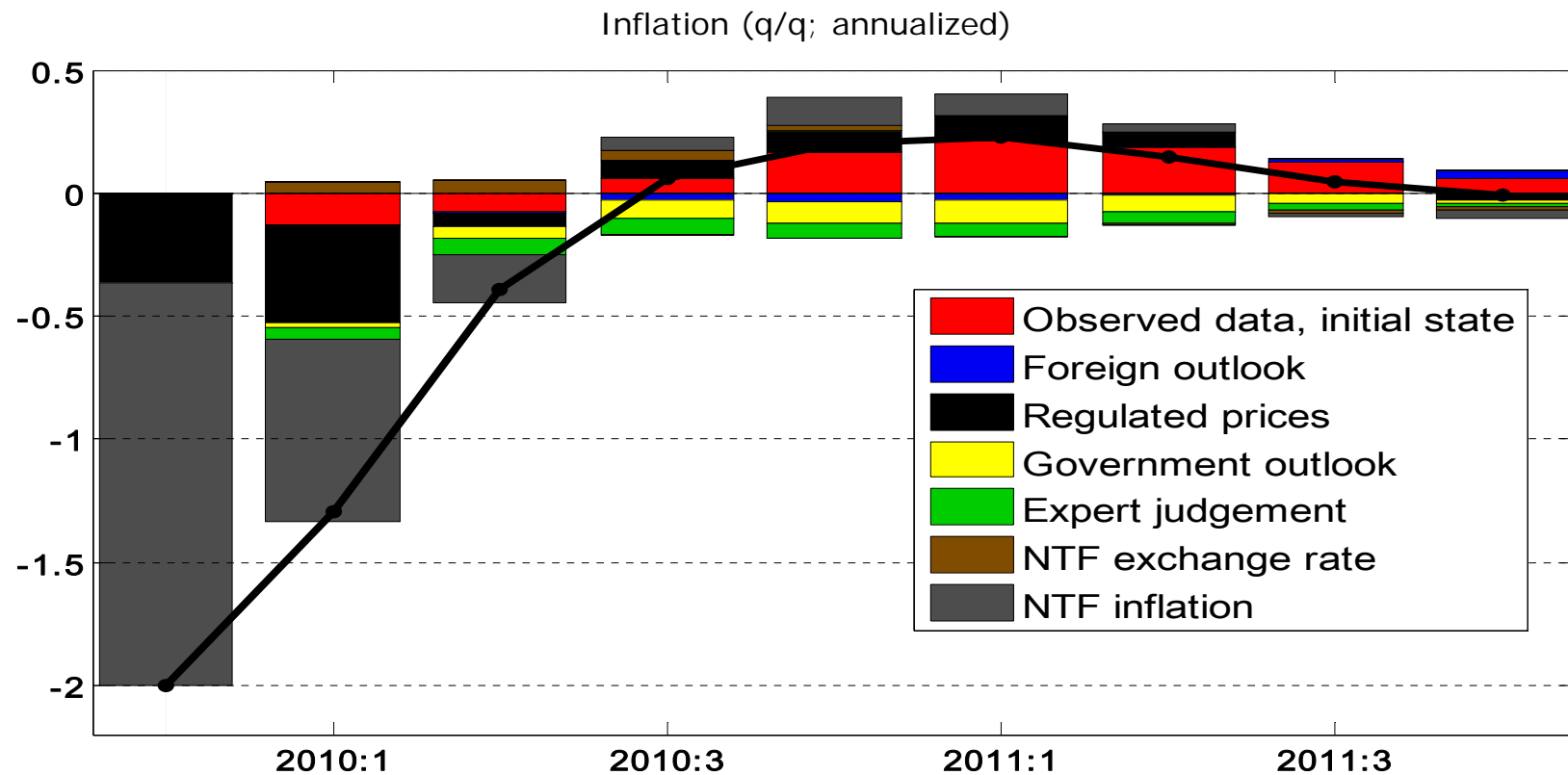
- Expected actual impact smaller (0.9 p.p.) than the primary impact for changes in VAT on non-regulated items.

Core Inflation and Food Prices



- Lower outlook both for core inflation and food prices;
- Reflects weaker economic activity, declining import prices and falling agricultural commodity prices.

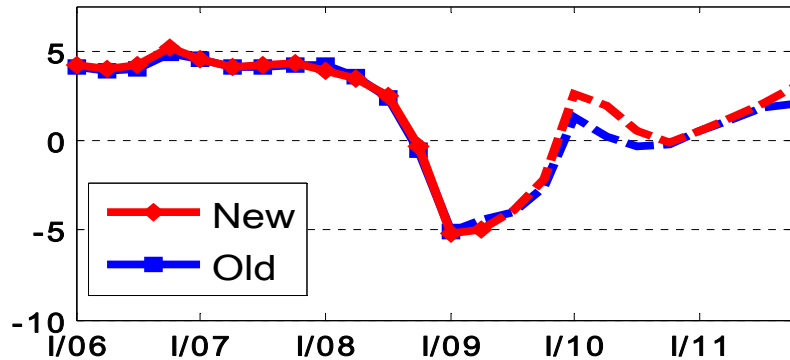
Inflation Forecast Change Decomposition



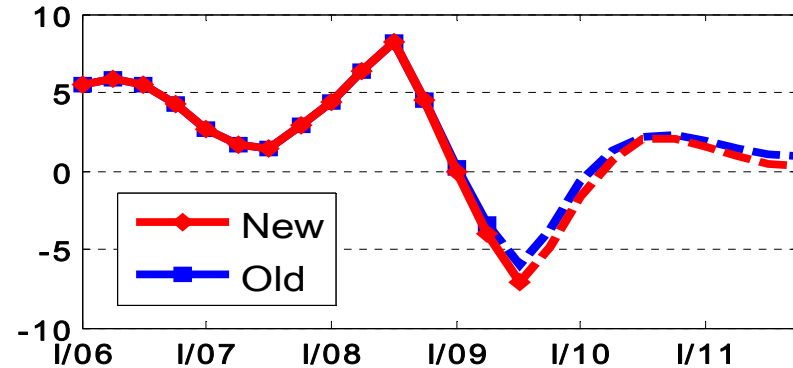
- Downward shift in near-term forecast for inflation and regulated prices, upward impact of faster wage growth (red bars);
- Almost no overall impact of changes in foreign outlook.

External Assumptions

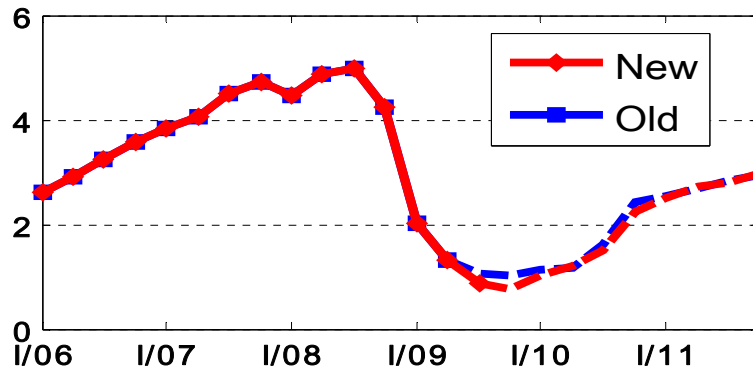
Growth Rate of GDP - Eurozone (y/y, in %)



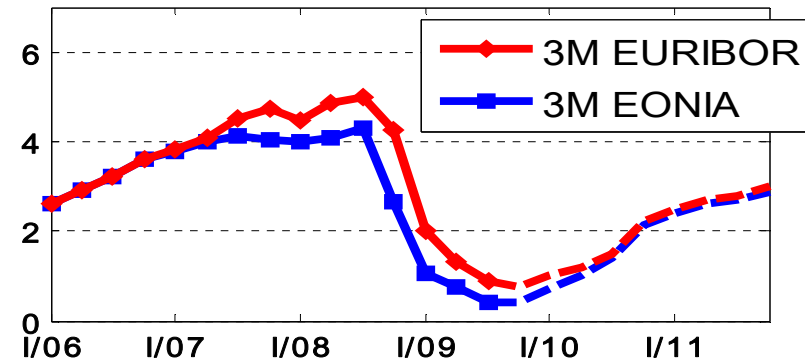
PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR



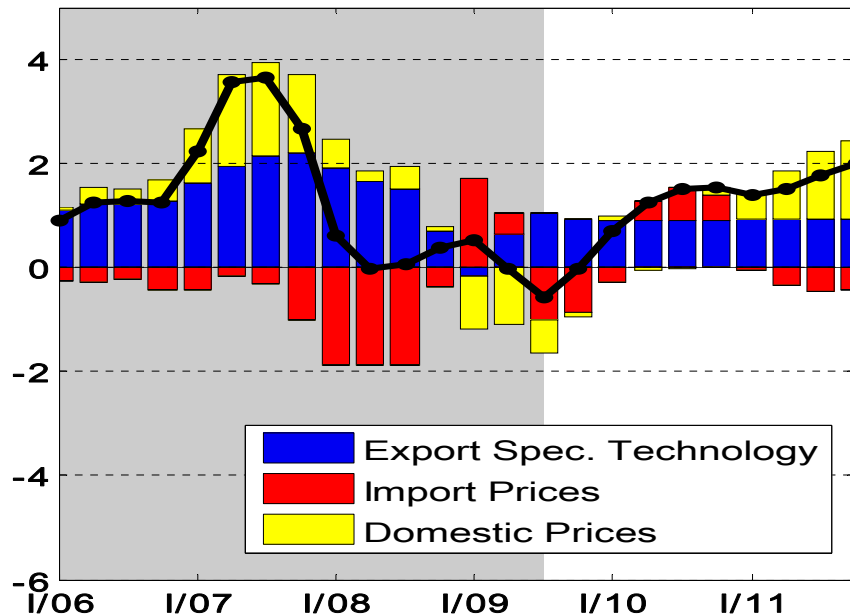
Interest Rate - Eurozone



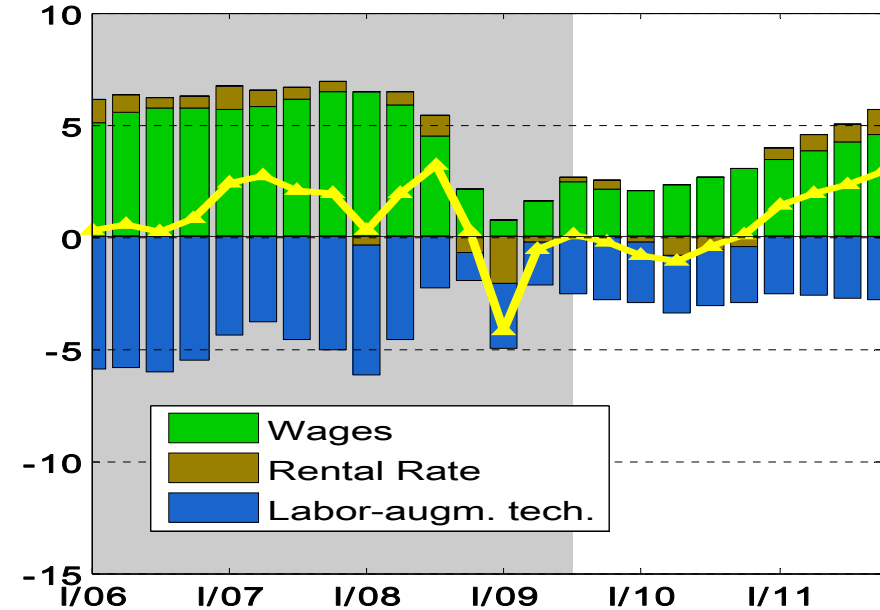
- Still a 'W-shaped' outlook for foreign GDP;
- Marginally lower forecast of foreign prices and interest rates.

Nominal Costs: Domestic Pressures vs. Import Prices

Nominal Marginal Cost in Consumption Sector
(q/q, in %, ann.)

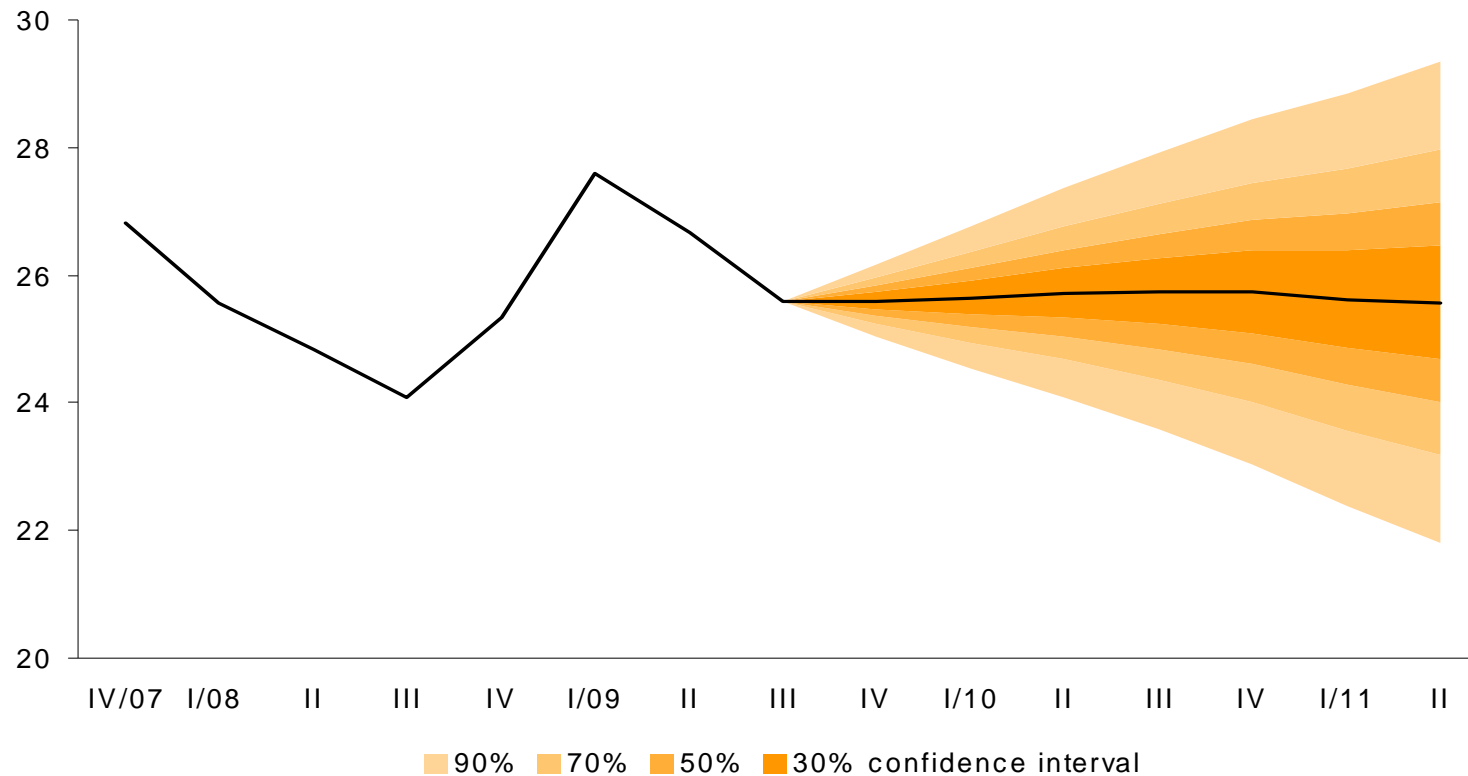


Nominal Marginal Cost in Domestic Sector
(q/q, in %, ann.)



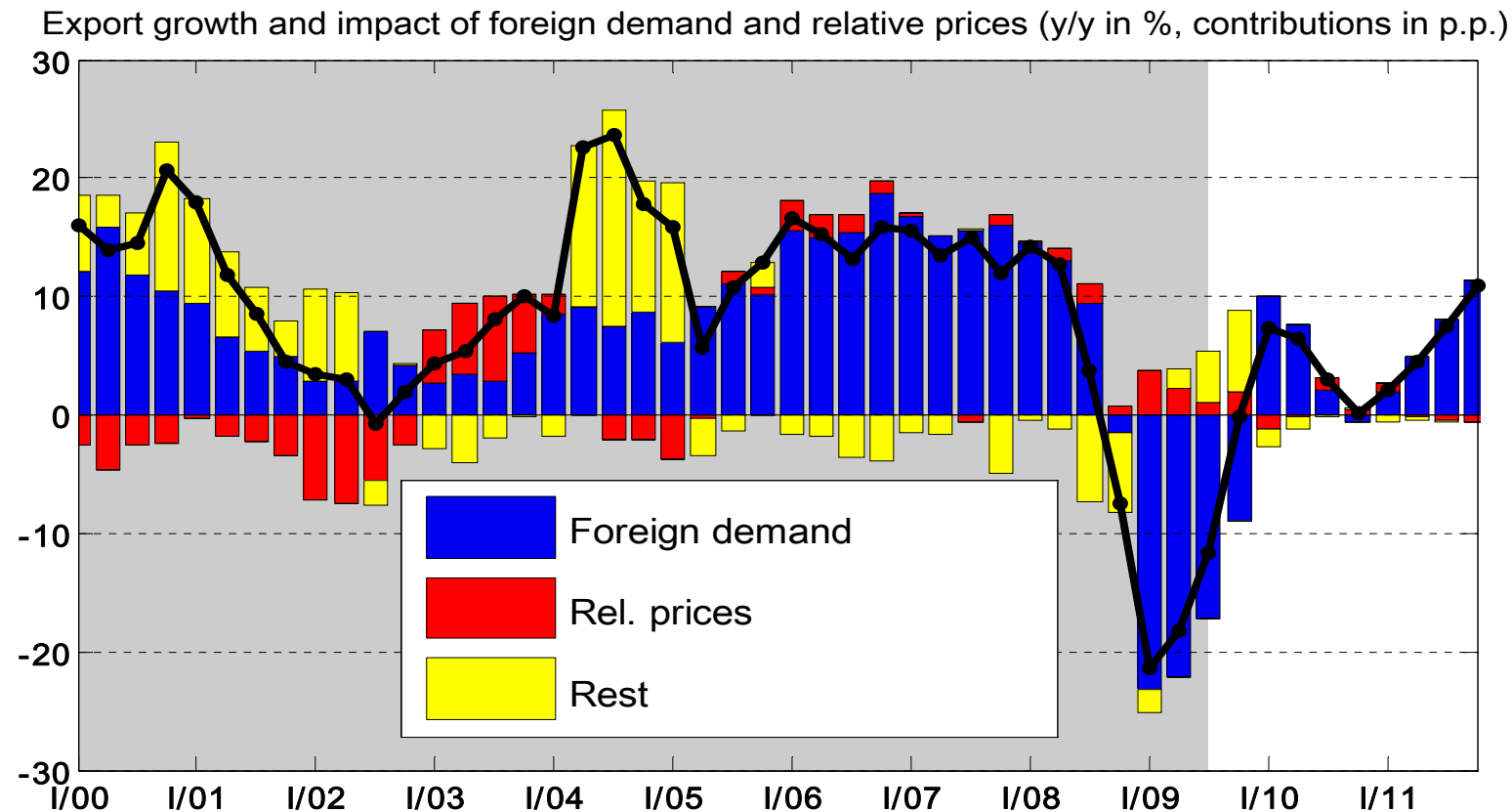
- Import prices have temporarily moved from pro-inflationary to anti-inflationary;
- The domestic anti-inflationary pressures reflect muted wage growth and low capacity utilization, but will fade away gradually;
- Profit margins currently depressed – potential pressure on their recovery via price increases (or cost reduction) in the future.

Exchange Rate Forecast (CZK/EUR)



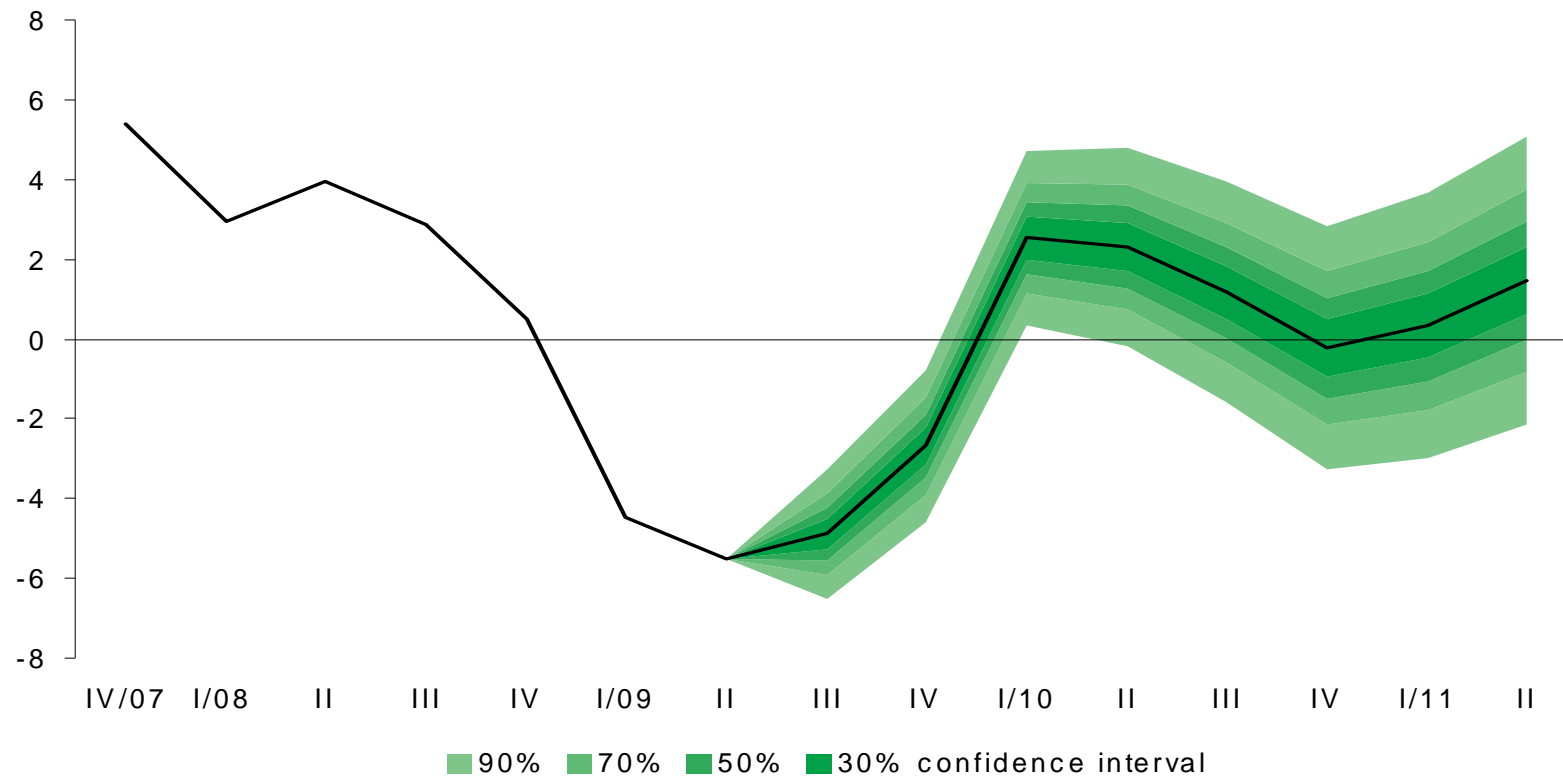
- The nominal exchange rate forecast is broadly stable;
- Moderate growth in import prices expected for 2010;
- The exchange rate is slightly stronger than in the previous forecast in the near term and slightly weaker in the medium term.

Export Growth Decomposition



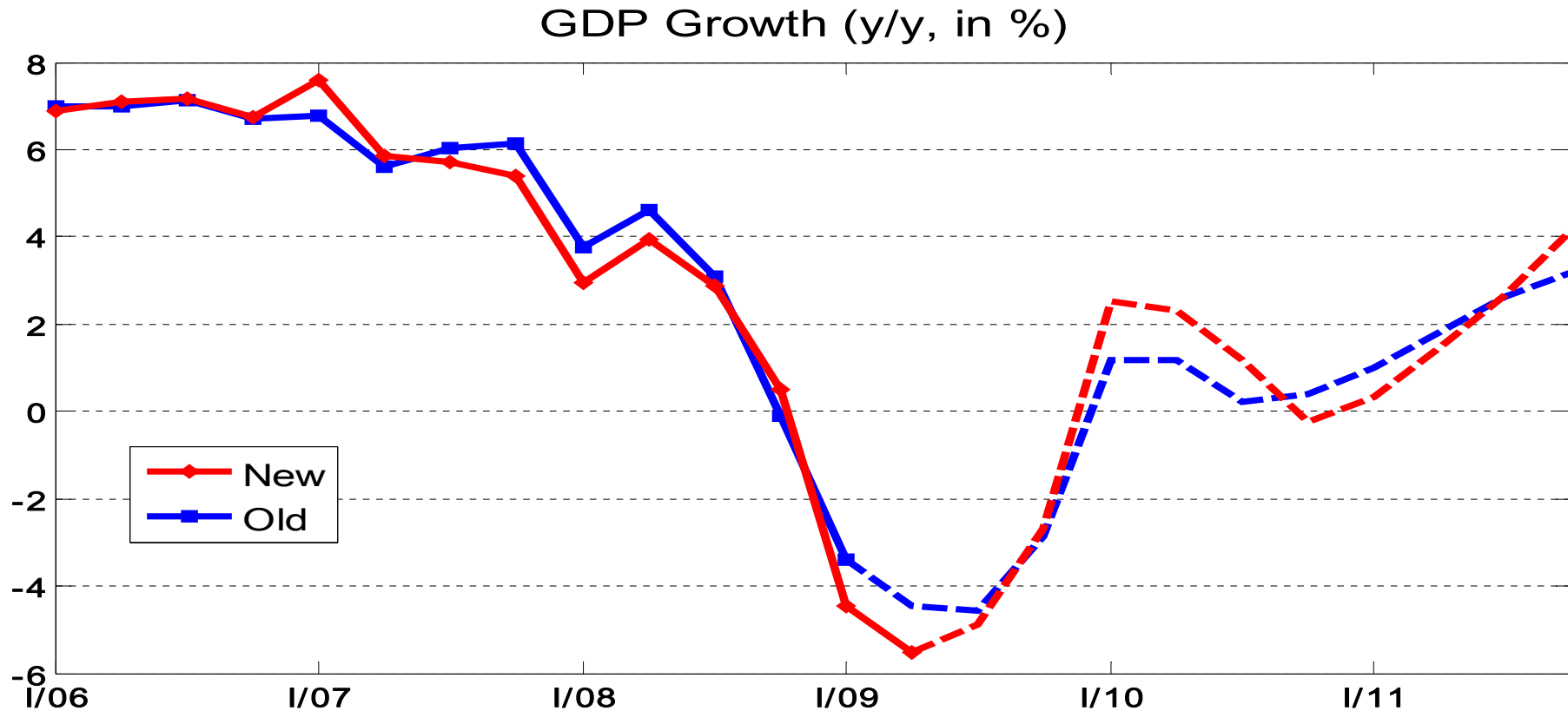
- According to a model-based decomposition, the past exchange rate depreciation has helped to reduce the impact of the drop in foreign demand, but only to a fairly limited extent.

GDP Growth Forecast



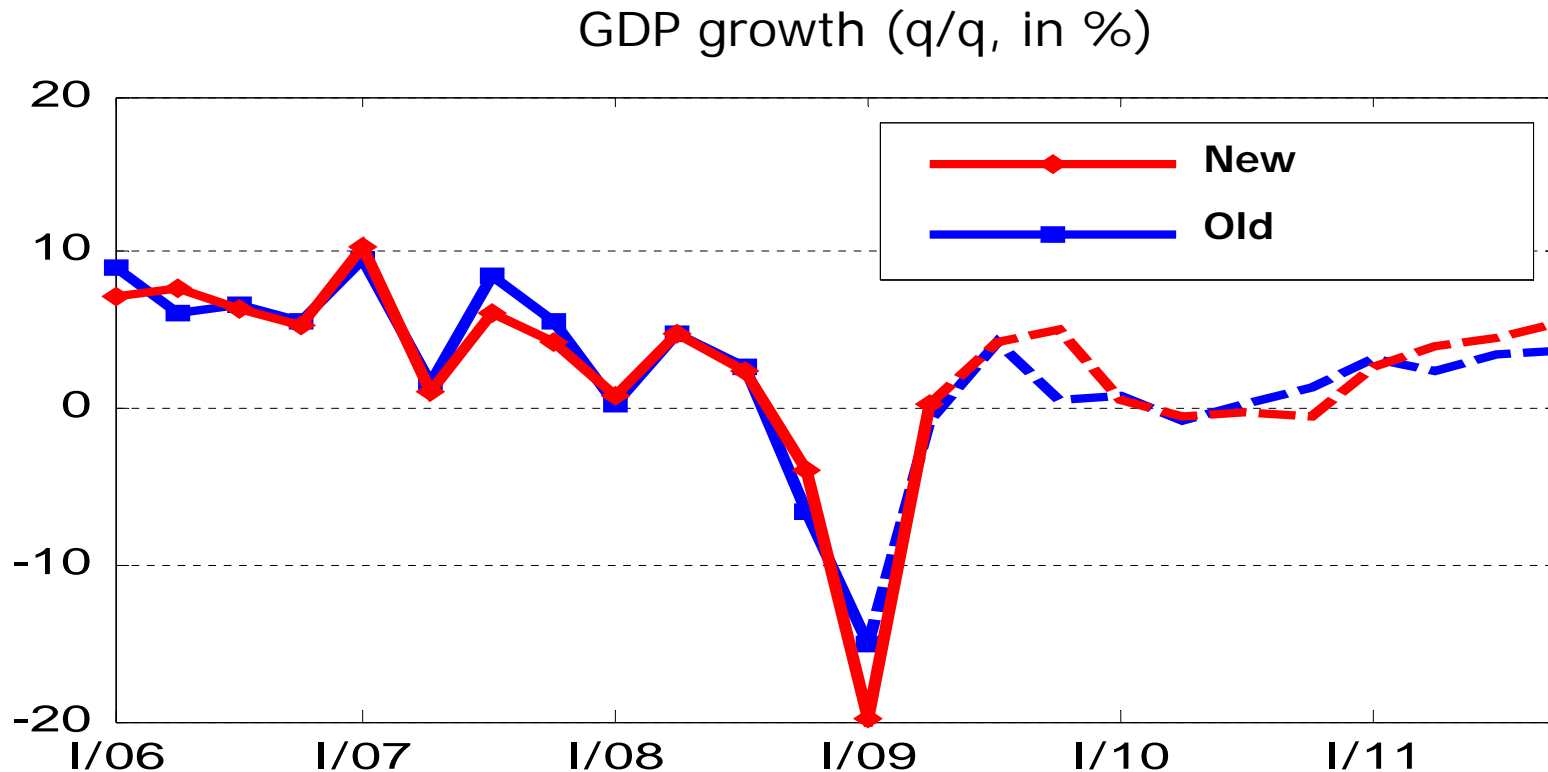
- 'W-shaped' recovery reflects the outlook for foreign demand (incl. end of car-scrapping subsidies), labour market slack and restrictive fiscal measures;
- Yearly averages: 2009: -4.4%, 2010: +1.4%, 2011: 2.2%.

Comparison with Previous GDP Forecast (i)



- GDP outlook shifted down for 2009 due to past data revisions;
- More pronounced recovery at the turn of 2010, but with a subsequent slowdown even below the previous forecast.

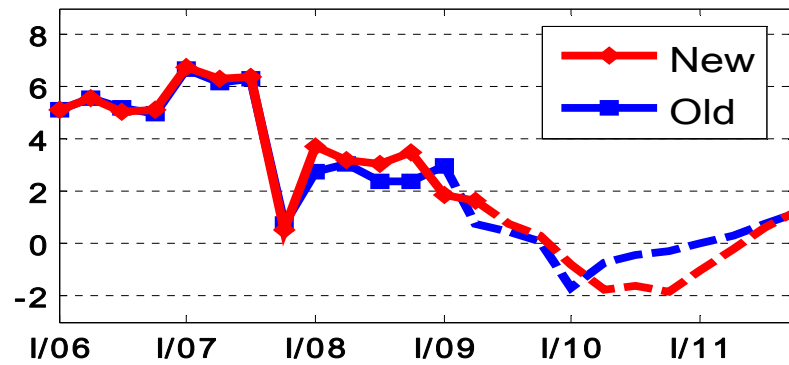
Comparison with Previous GDP Forecast (ii)



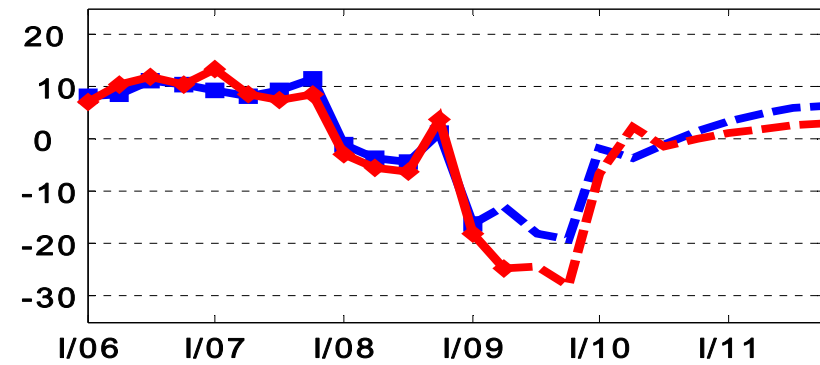
- GDP has bottomed out in q/q terms;
- Improved outlook for the rest of 2009, but a loss of dynamics expected during 2010.

Forecast of Aggregate Demand

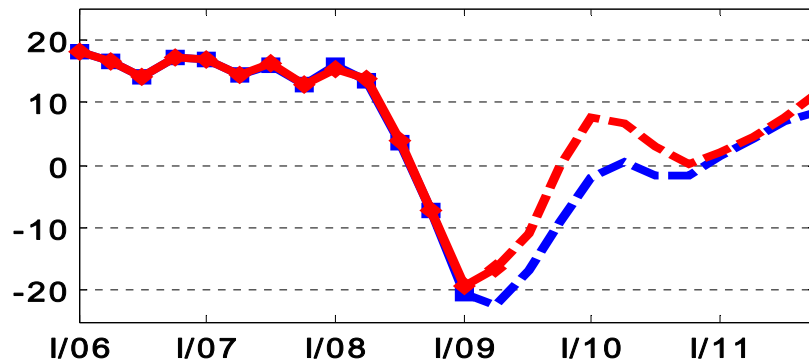
Household Consumption Growth (y/y, in %)



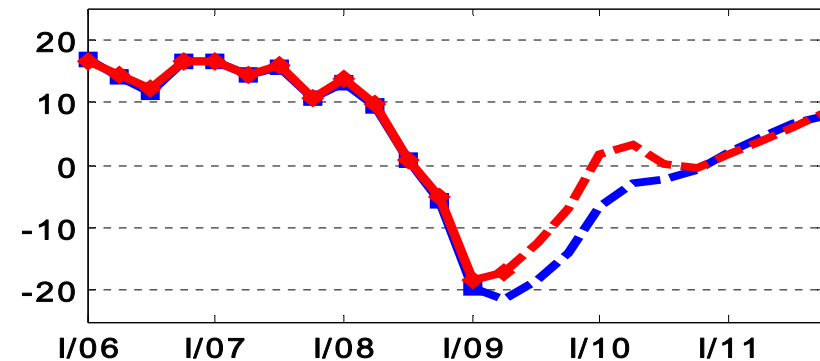
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

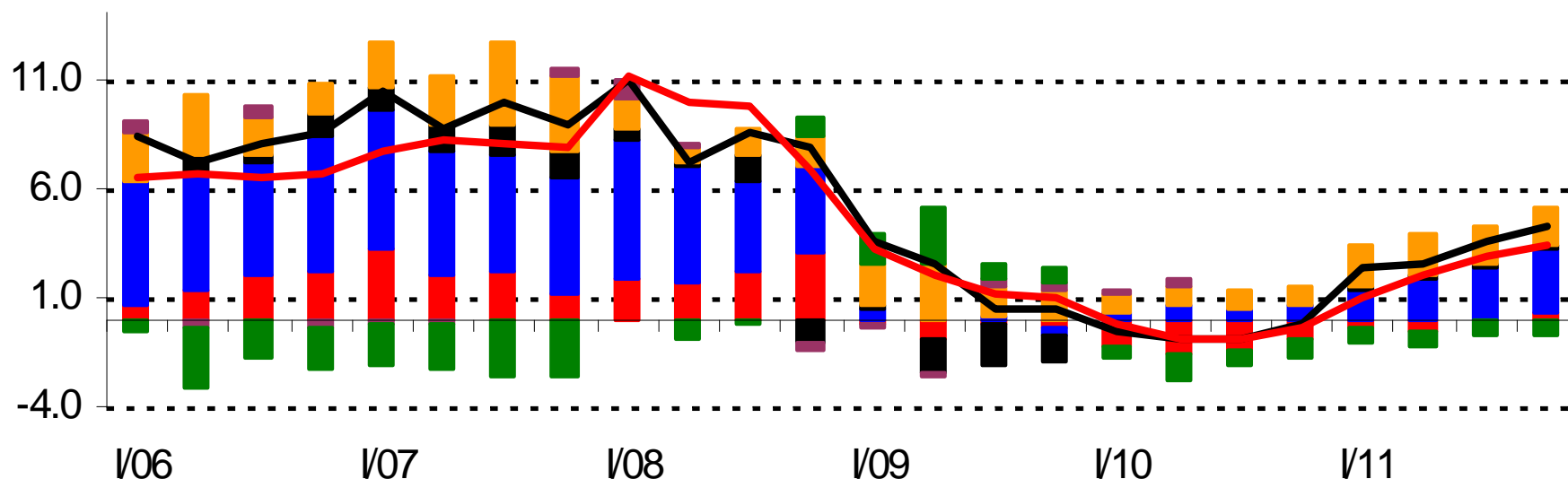


Imports Growth (y/y, in %)



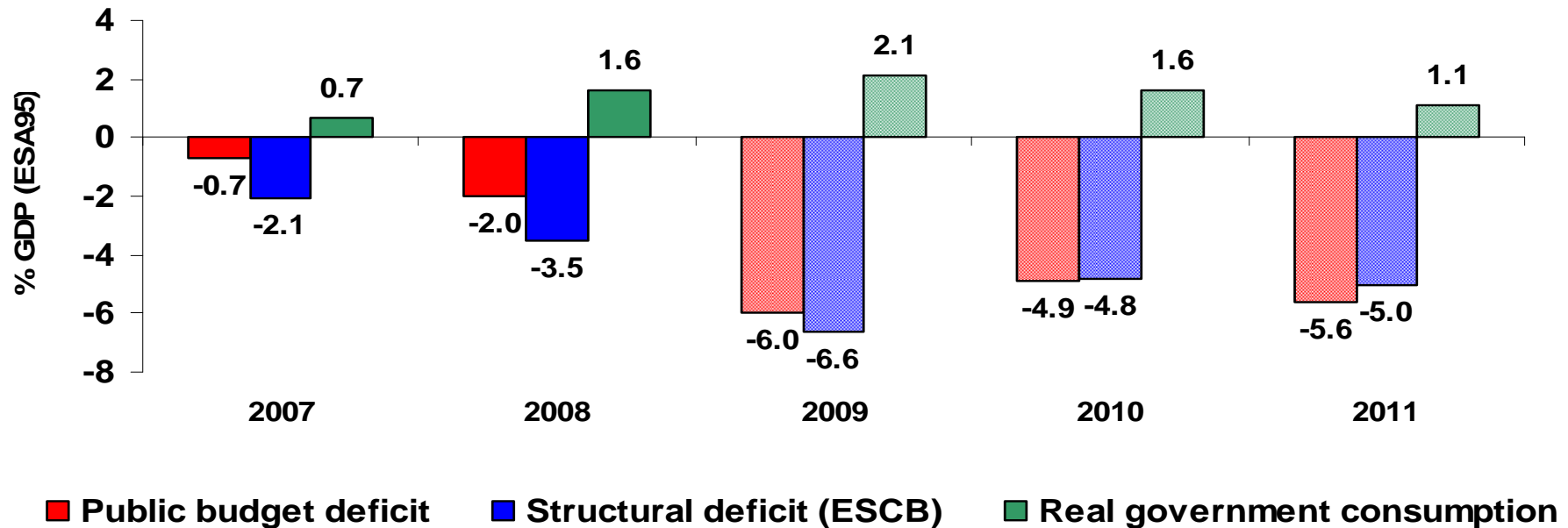
- Household consumption affected by the fiscal measures;
- Better prospects for foreign trade;
- Deeper than expected drop in total investment in 2009.

Nominal Consumption and Disposable Incomes Growth



- Fiscal restrictions will reduce the growth of nominal disposable income in 2010 and increase the price growth due to indirect tax changes.

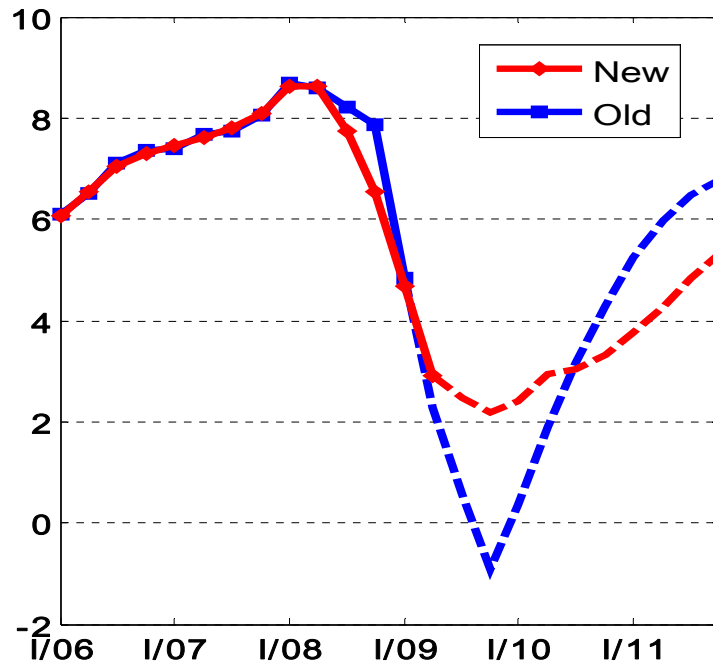
Public Budgets



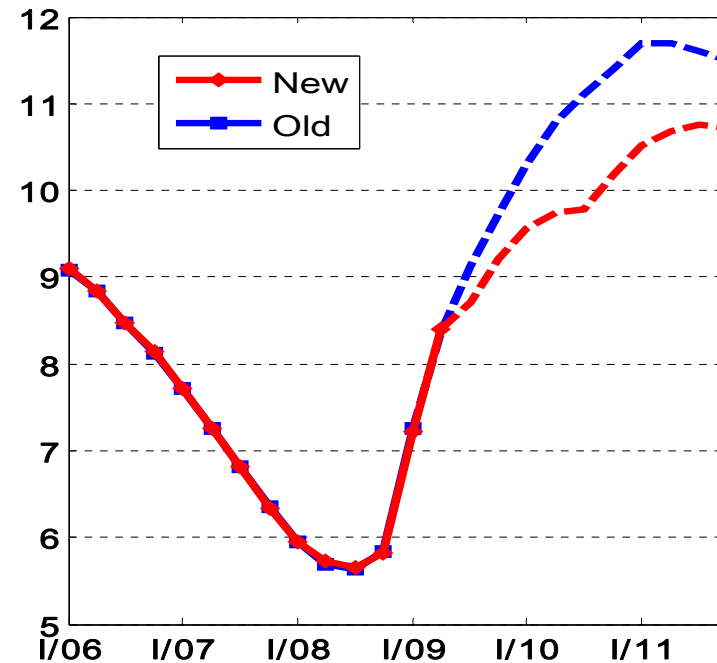
- Forecast of the deficit in 2010 reduced to around 5% of GDP;
- The total budgetary impact of the austerity measures exceeds 2% of GDP in 2010-2011;
- Estimated impact on GDP growth: -0.8 p.p. in 2010; -0.3 p.p. in 2011.

Labour Market Forecast

Nominal wage growth in business sector
(y-o-y, in %, s.a.)

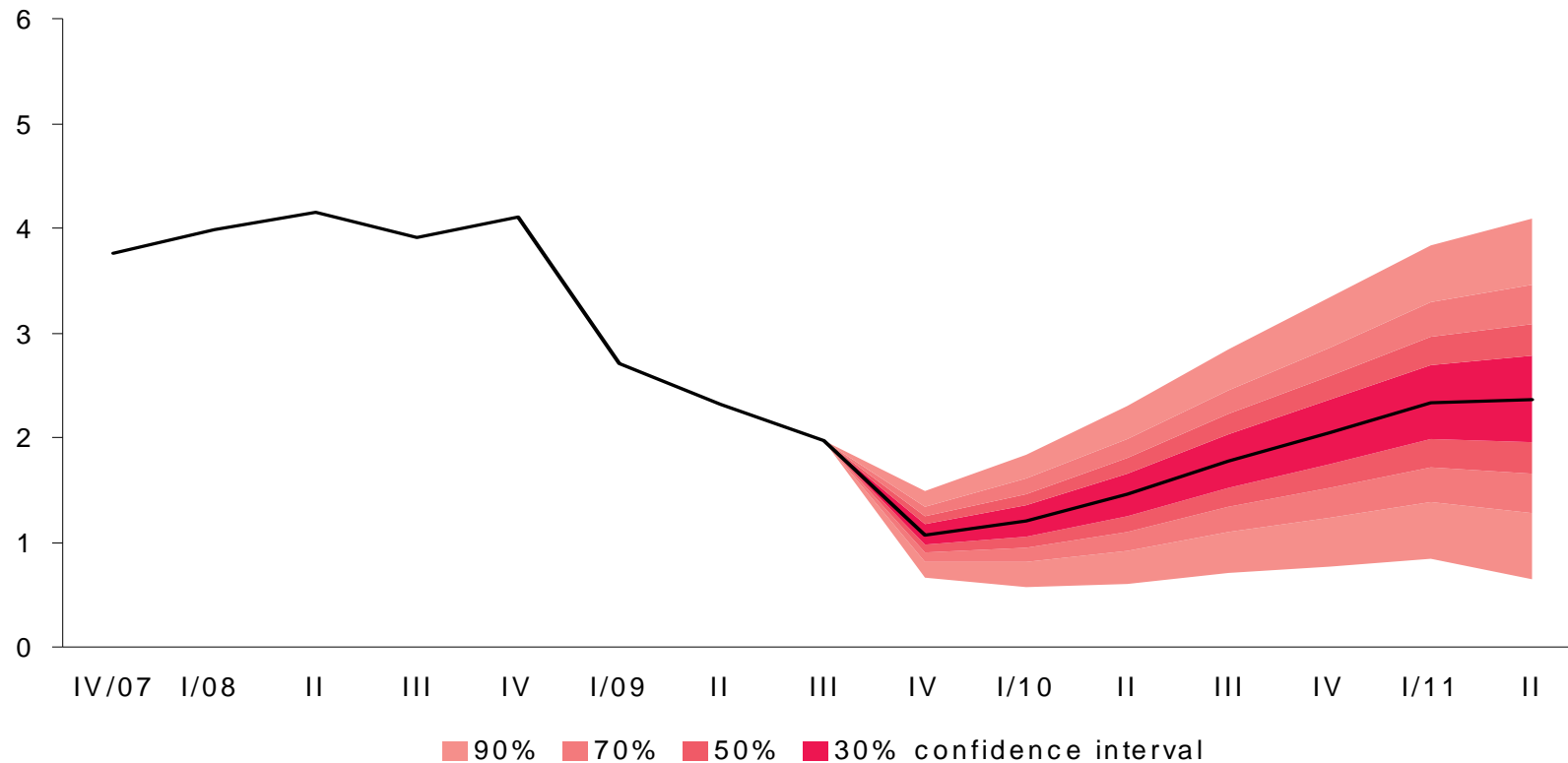


Total registered unemployment rate
(in %, s.a.)



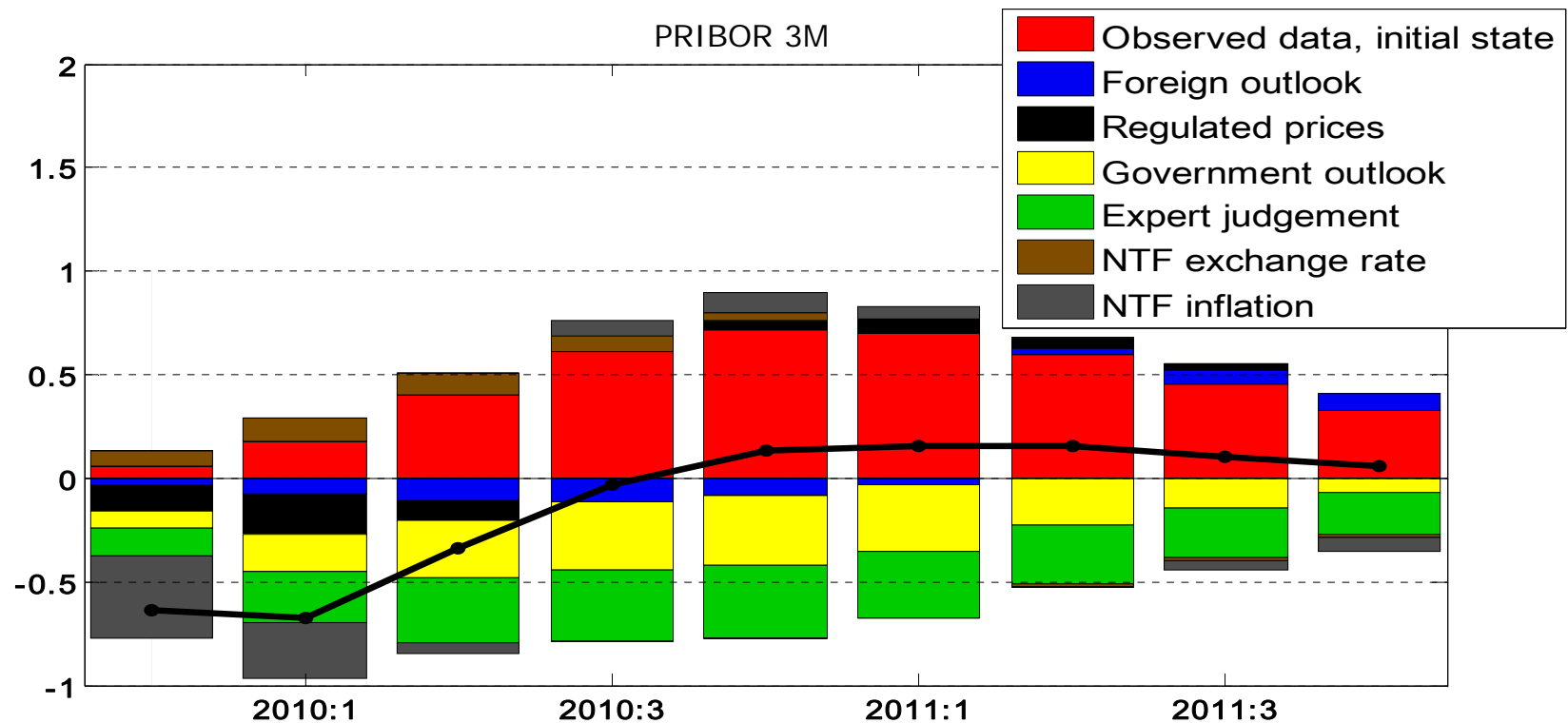
- Compared to the previous forecast, the labour market response is more gradual both in terms of wage growth and unemployment;
- Peak in the unemployment rate at the turn of 2011;
- October 2009: unemployment in line with the forecast.

Interest Rate Forecast



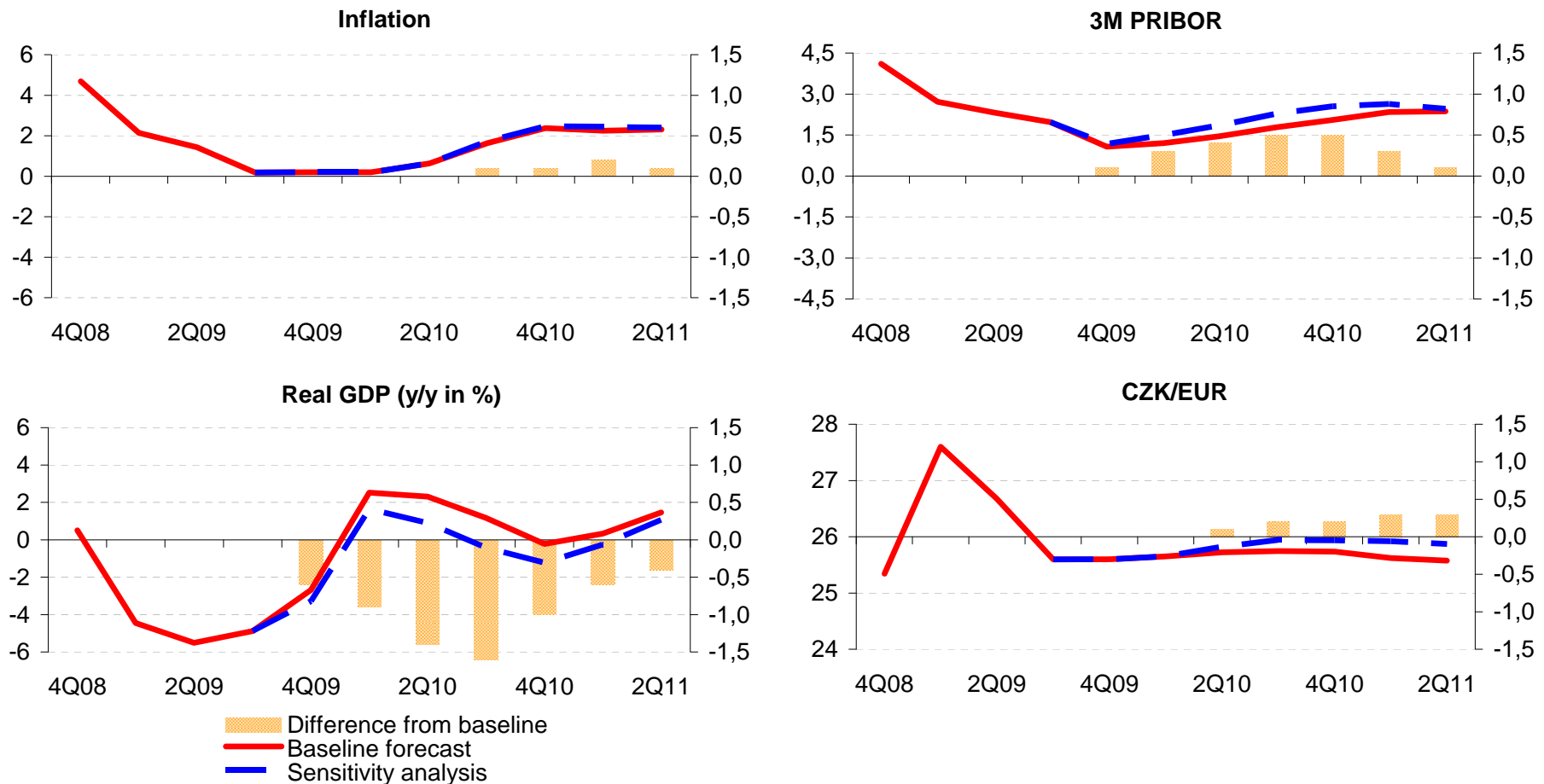
- Consistent with the forecast is a decline in market interest rates this year followed by a gradual rise in 2010;
- Compared to the previous forecast, the interest rate path is significantly lower for the near term.

Interest Rate Forecast Change Decomposition



- Downward impact of near term forecast of inflation, regulated prices and expert judgment (incl. fiscal measures);
- Upward impact of 'initial state' (mainly faster wage growth).

Sensitivity Analysis: Slower Productivity Growth



- Captures the uncertainty about post-crisis potential growth;
- Implies slower GDP growth and higher interest rates.

Comparison of the CNB's Forecast with Analysts' View

	CNB		ANALYSTS	
GDP in % (2009)		-4.4		-4.4
GDP in % (2010)		1.4		1.6
CPI in %		2.4 (4Q/2010)		2.5 (10/2010)
Exchange rate CZK/EUR		25.7 (4Q/2010)		25.0 (10/2010)
Interest rate in %	3M PRIBOR	2.0 (4Q/2010)	2T REPO	1.6 (10/2010)
			12M PRIBOR	2.7 (10/2010)
Nominal wages in % (2009)		2.6		2.6
Nominal wages in % (2010)		2.2		1.9

Source: Financial Markets Inflation Expectations (CNB's Survey), October 2009

- Forecasts of analysts in general similar to the CNB's forecast;
- Analysts expect stronger CZK/EUR exchange rate.



Thank you
for your attention.

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CNB